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Ruminations on Security Devices

Michael H. Rubin*

I. LEASE AND ASSIGNMENTS

In commercial properties, a common form of financing involves giving a creditor a right to the income stream generated by the property. Often the landlord is not the owner of the property, but is rather itself a lessee from the property owner (the "Ground Lessor"). The management of the income stream is crucial to a number of parties. The landlord who manages and leases the property to the tenants (whether these be tenants in an office building or tenants in a commercial shopping center) needs the cash to pay current expenses and to keep up the property. On the other hand, this income stream also is the primary source of collateral and loan repayment for lenders who have advanced money to the landlord to construct improvements, and this cash flow is crucial to repayment of both principal and interest.

Lenders want a security interest that will allow immediate use of these monies. Landlords, on the other hand, wish to keep as much control of the cash flow as possible and to prevent lenders from prematurely obtaining these funds, thereby depriving landlords of these needed monies. The tension between the competing interests is the subject of recent developments in bankruptcy and Louisiana law.¹

A. Louisiana Keeper Provisions

Louisiana law specifically allows parties in loan documents to designate contractually who will manage the property in the event of a default; this is known as the "keeper" appointment under Louisiana law.² The parties may identify in the mortgage or in a security agreement either the person who is to

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1. It is beyond the scope of this article to deal with bankruptcy developments; suffice it to say that, in the Fifth Circuit, pre-petition secured lenders were able to control post-petition rents, including hotel rents. *In re T-H New Orleans Ltd. Partnership*, 10 F.3d 1099 (5th Cir. 1993), *cert. denied*, 114 S. Ct. 1833 (1994). After the 1994 amendments to the Bankruptcy Code the same result was mandated nationwide. Bankruptcy Code, Section 552.

2. La. R.S. 9:5136 (1991).

serve as the keeper or they may describe a method by which the keeper is to be appointed.³ Upon seizure of the property by a creditor under a mortgage or security agreement, the court is required to direct the sheriff to appoint as the keeper the person designated in the documents.⁴ If the parties have not designated a keeper or a mechanism for appointment, then the sheriff may be the keeper or, failing that, a person appointed by the court.⁵ A keeper has broad powers in administering the property.⁶ Beyond the mere act of administering and preserving the property, the keeper has "full powers of management . . . of the property and may operate the property seized . . . in the ordinary course of business."⁷ A keeper may use revenues generated during the course of the administration to pay for the keeper's costs and expenses.⁸ If the keeper's costs and expenses exceed the revenues generated, the keeper appointed by agreement of the parties in a mortgage may recover costs of administration only if the documentation between the parties expressly provides a manner for determining the compensation.⁹ If the keeper is court-appointed the law allows all costs and expenses to be "administration" expenses,¹⁰ but approval of these expenses is subject to court oversight and approval.

A keeper appointed by agreement of the parties is not required to put up a bond if the seizing creditor is one of the parties to the agreement;¹¹ on the other hand, if the parties have not agreed to a keeper, then a bond must be fixed by the court "at such reasonable sum as the nature of the case justifies."¹²

As can be seen, the entire structure is to allow the parties to appoint a keeper to run the property during the course of seizure; although appointed by agreement of the parties, the keeper is placed in possession by court order during the course of a judicial seizure and acts under court supervision.

Problems may arise when there are multiple lenders and the keeper acts for the benefit of the seizing creditor rather than for the benefit of all creditors. A case on point is *W.A.C., Inc. v. Day*.¹³

W.A.C. dealt with competing claims to rental income collected by a keeper. The claimants were the second mortgagee who appointed the keeper, and a superior creditor whose security included an assignment of rents. It was only after the keeper was appointed and after the keeper had diverted the rental income to the second mortgagee that the superior creditor intervened and claimed not only the rents from that point forward, but also past rents sent to the second mortgagee.

3. La. R.S. 9:5136 (1991).

4. La. R.S. 9:5137(A) (1991).

5. La. R.S. 9:5137(B) (1991).

6. La. R.S. 9:5138 (Supp. 1996).

7. La. R.S. 9:5138(A) (Supp. 1996).

8. La. R.S. 9:5138(C) (Supp. 1996).

9. *Id.*

10. *Id.*

11. La. R.S. 9:5139(A) (1991).

12. La. R.S. 9:5139(B) (1991).

13. 649 So. 2d 971 (La. App. 1st Cir. 1993).

In finding that the second mortgagee was entitled to keep the monies already collected, the court stated, citing *Corpus Juris Secundum* as authority: "We, therefore find that the rental income collected by the keeper appointed by the second mortgagee inures to the benefit of the second mortgagee until such time as a superior creditor takes action to enforce its claim."¹⁴

While *Corpus Juris Secundum* accurately reflects the common law result, and while the American Law Institute's Proposed "Restatement of the Law of Property, Mortgages" adopts the same view,¹⁵ it is questionable whether civil law principles should lead to the same result. A keeper arguably is not a mere functionary of the appointing party but rather a court-appointed agent who, it is submitted, should act as a fiduciary. A primary purpose of requiring court-appointment and supervision of a keeper is to prevent self-help and to provide someone who acts solely under court guidance and authority. While Louisiana Revised Statutes 9:5136 allows creditors to designate who the keeper will be, and while typical loan documentation reflects these powers, the question is still a legal one: may the keeper act purely and solely for the nominating creditor's benefit, disregarding the rights of all other secured parties? A keeper's standard of care is the same as a trustee under the Louisiana Trust Code; both must perform their duties as "a prudent administrator," or as a "prudent man."¹⁶ It would seem that the keeper must act as a fiduciary for both the court and all secured creditors, not merely for the appointing creditor.

Perhaps this case should not be read as predictive of the result in all instances because it involved a question whether the assignment of rents in the mortgage was sufficient under then-applicable law; however, since the case was decided the law has changed.

14. 649 So. 2d at 973.

15. See *Restatement of the Law Property—Security (Mortgages)* § 4.5(b) (Tentative Draft No. 3, 1994) (approved May, 1995):

(b) When a junior mortgagee obtains the appointment of a receiver, that receiver has the right, until a receiver is appointed under a senior mortgage, to collect rents from the mortgaged real estate and, after first using them to pay real estate taxes and other reasonable expenses associated with the maintenance and repair of the real estate, to apply the balance to the junior mortgage obligation.

16. La. R.S. 9:2090 (1991). The "prudent man" rule in the Louisiana Trust Code has a long history in common law and is reflected in detailed requirements in the American Law Institute's *Restatement of The Law of Trusts*, both the second and third editions. The Official Louisiana Law Institute Comments, created in 1964 when the Louisiana Trust Code was enacted, showed that the *Restatement (Second)* was the source of many provisions of the Louisiana Trust Code. Further, Louisiana courts from time to time have looked to the *Restatement* for help in interpreting the scope of a trustee's duties. See, e.g., *City of New Orleans v. Cheramie*, 509 So. 2d 58, 60 (La. App. 1st Cir. 1987); *Vuskovich v. Thorne*, 498 So. 2d 1072, 1078 (La. 1986) (Dennis, J., dissenting). The American Law Institute's *Restatement of the Law of Trusts* (3d ed. 1990) uses the term "prudent investor" and makes other changes in the standard of care; however, the changes relate to obligations of the trustee as a fiduciary. There never is any question that the trustee is and must act as a fiduciary.

B. Change in Louisiana Revised Statutes 9:4401

Louisiana Revised Statutes 9:4401 was revised to make it easier to obtain and perfect an assignments of rents. The statute, as amended, creates a general rule of ranking. Whether the assignment is styled as a "conditional assignment" or an "absolute assignment" does not make a difference;¹⁷ once a lender has perfected an assignment, it is superior to later-filing creditors. The act provides:

As future leases or rents of an immovable come into existence the assignee's rights as to such leases and rents shall be deemed perfected from the date of the filing of the instrument. * * * Once an assignment relating to leases or rents of an immovable is so filed, the assignee shall have a superior claim to the leases and rents assigned and their proceeds as against all other creditors whose claims or security interests arise or are perfected after the filing of the assignment. . . .

The Act further provides that an assignment may be "expressed as a conditional or collateral assignment . . . [and] shall become absolute upon the assignor's default in respect to the obligation thereby secured." In other words, the Act contemplates retroactive rank.¹⁸

17. The Court in *W.A.C., Inc.*, 649 So. 2d at 974, seemed to distinguish between a "conditional assignment of rents" and an "absolute mortgage of rents." This is a misnomer; one cannot "mortgage" rents in Louisiana; the only way to grant a security interest on rents is through the provisions of La. R.S. 9:4401 (Supp. 1996).

18. It is not unusual for future loans to be secured retroactively to the date of the filing of a document. That is the case with future advance mortgages, La. Civ. Code art. 3298, as well as the collateral mortgage. See La. R.S. 9:5551 (Supp. 1996); La. R.S. 5552 (1991); *New Orleans Silversmiths v. Toups*, 261 So. 2d 252 (La. App. 4th Cir.), writ denied, 263 So. 2d 47 (1972). See also David S. Willenzik, *Future Advance Priority Rights of Louisiana Collateral Mortgages: Legislative Revisions, New Rules, and a Modern Alternative*, 55 La. L. Rev. 1 (1994); Michael H. Rubin & Stephen P. Strohschein, *Security Devices*, 55 La. L. Rev. 613 (1995).

Jefferson Guar. Bank v. Lagos, 646 So. 2d 1078 (La. App. 5th Cir. 1994) (citing *Texas Bank of Beaumont v. Bozorg*, 457 So. 2d 667 (La. 1984), and *New Orleans Silversmiths, Inc. v. Toups*, 261 So. 2d at 252 (La. App. 4th Cir.), writ denied, 262 La. 309, 263 So. 2d 47 (1972)), held that under the unequivocal language of the Civil Code (the case having arisen under a collateral mortgage before 1990), future loans are secured retroactively to the earliest concurrence of pledge of the collateral mortgage note plus recordation of the collateral mortgage plus intent of the parties to use the pledge of the collateral mortgage note to secure future advances. In *Jefferson Guaranty Bank*, a collateral mortgage holder who advanced monies before and after the recordation of a judicial mortgage outranked the judicial mortgage holder, regardless of the time the collateral mortgage lender advanced the funds. The Court stated the following about La. Civ. Code art. 3158 (although the same rule now applies under La. R.S. 9:5550 for collateral mortgages entered into after January 1, 1990):

LSA—C.C. art. 3158 allows a secured collateral mortgage holder to advance sums secured by that collateral mortgage after the recording of a subsequent security device, similar to the judicial mortgage in this case. New money can be advanced, old debts consolidated, and new debts incurred, and these can be secured by the collateral mortgage as long as there is a manifestation of a specific intent to secure the advance by the collateral mortgage.

Jefferson Guar. Bank, 646 So. 2d at 1081.

C. *The Public Records Doctrine, Equity, Taxes, and Keepers as Fiduciaries*

W.A.C., Inc. v. Day,¹⁹ in holding that a superior creditor who does not intervene in the lawsuit concerning the rents is not entitled to the rents collected by the keeper until an intervention occurs, may appear to be an equitable doctrine; deeper analysis, however, may cast doubt on this appearance. A security interest in rental income requires use of the public records to affect third parties, and the Louisiana Public Records Doctrine,²⁰ which incorporates the rule of *McDuffey v. Walker*,²¹ has never been one whose rationale rests in the common law concepts of equity. Rather, the Public Records Doctrine is based upon a "bright line" test, one that it is totally predictable and which does not depend upon an equitable balancing of interests. It depends upon the *absence* from the public records of something putting third parties on notice.²² If a mortgage is not recorded, it cannot affect third parties even if third parties are otherwise aware of the mortgage. Under Louisiana law, if Seller transfers the property to Purchaser One and then later to Purchaser Two, nevertheless Purchaser Two owns the property as to the world if he records the act of sale first, despite Purchaser Two's knowledge of the act of sale to Purchaser One.²³

W.A.C.'s citation to *Corpus Juris Secundum*, its adoption of common law rationale and citation of common law authorities, and its acceptance of a result mandated by a common law approach, seems to be antithetical to both civilian methodology and the fiduciary duties of a keeper. For example, *W.A.C.* also held that the keeper could not be liable for tax penalties incurred by the superior lender after the keeper failed to pay property taxes. The court reasoned that "the fact that a portion of the proceeds of the sale of the property must be paid in tax penalties is due to the lack of diligence by the holder of the first mortgage."²⁴ The court found it was this "lack of diligence" that led to tax penalties. "We, therefore, find that in this case, the second mortgagee's keeper incurred no duty to the first mortgagee and cannot be held liable."²⁵ The finding that a court-appointed keeper, whose standard of care is to act prudently, could fail to pay property taxes with rental income and not be liable to a creditor with a superior claim on the rents appears curious.

First, the due process rules of *Mennonite*²⁶ reject an approach that looks to the "diligence" of the secured party to protect its property interests from

19. 649 So. 2d at 971.

20. La. R.S. 9:2721 (Supp. 1996).

21. 125 La. 152, 51 So. 100 (1909).

22. Third parties are defined in La. Civ. Code arts. 3309 and La. R.S. 9:2722; if one is not a third party, recordation in the public records is irrelevant. *Commercial Nat'l Bank of Shreveport v. McDaniel*, 156 So. 43 (La. App. 2d Cir. 1934).

23. *McDuffie v. Walker*, 125 La. 152, 51 So. 100 (La. 1910).

24. 649 So. 2d at 974-75.

25. 649 So. 2d at 975.

26. *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 103 S. Ct. 2706 (1983).

diminishment through state action or those acting as agents of the state or its courts.²⁷ *Mennonite* held that regardless of whether one is a sophisticated or unsophisticated lender, certain procedural requirements must be followed before one can be deprived of property rights, and a security interest clearly is a property right.²⁸ The most important procedural rule is actual notice by mail prior to the deprivation.²⁹ In *W.A.C.*, the superior secured lender suffers losses without actual prior notice. The losses were a result of the court-appointed keeper's failure to pay property taxes and using the money to pay down the second lender's loan. If the state cannot deprive a secured lender of a property interest without prior notice, it seems strange that a court-appointed fiduciary may do so; yet, that is the holding of the *W.A.C.* case. The result of *W.A.C.* seems to be counter to the teachings of *Mennonite* and its progeny.³⁰

Second, the *W.A.C.* court rejected the rationale that the keeper was a fiduciary for all creditors; yet, the keeper was appointed by the court. If the property had been sold for taxes while in the keeper's possession, and if the redemption period had expired, it would appear that any court appointing the keeper would have found some problem with the keeper's administration of the property. The keeper has a duty to maintain the property and even has the ability to operate it in "the ordinary course of business."³¹ The power to maintain the property ought to carry with it a corresponding duty to pay necessary expenses, such as taxes. Even the common law would reject this portion of *W.A.C.* and would require the keeper or receiver to use rental income to pay property taxes.³² Perhaps later cases will question whether a keeper may sit idly by and collect rents and funnel them to the party making the appointment.

The *W.A.C.* analysis, in its stress on the "lack of diligence" of the creditor whose security interest was first in time, seems in part to be based on a concept of "fault," a theory not incorporated into the Louisiana Public Records Doctrine.

27. As the Supreme Court stated in the *Mennonite* opinion:

Personal service or mailed notice is required even though sophisticated creditors have means at their disposal to discover whether property taxes have not been paid and whether tax sale proceedings are therefore likely to be initiated. . . . More importantly, a party's ability to take steps to safeguard its interests does not relieve the State of its constitutional obligation.

462 U.S. 791, 799, 103 S. Ct. 2706, 2712 (1983).

28. *Id.* at 798, 103 S. Ct. at 2711; *Davis Oil Co. v. Mills*, 873 F.2d 774 (5th Cir. 1989).

29. Notice by mail is a "minimal constitutional" requirement. *Mennonite*, 462 U.S. at 800, 103 S. Ct. at 2712.

30. The Fifth Circuit Court of Appeal has dealt with the issue of a secured lender's rights to due process numerous times. See *Davis Oil Co. v. Mills*, 873 F.2d 774 (5th Cir. 1989); *Small Engine Shop v. Cascio*, 878 F.2d 883 (5th Cir. 1989); *Sterling v. Block*, 953 F.2d 198 (5th Cir. 1992).

31. La. R.S. 9:5138 (Supp. 1996).

32. See Restatement, *supra* note 15. As the Reporters' Notes to Section 4.5(b) indicate, "Some state statutes require that a mortgage receiver apply rents and profits to real estate taxes as a priority claim. See, e.g., Iowa Code §§ 654.14, 680.7; *Presidential Realty Corp. v. Bridgewood Realty Investors*, 498 N.W. 2d 694 (Iowa 1993)." *Id.* at 49.

It would appear a more appropriate inquiry is not to ask which party was at "fault" for "lack of diligence," but rather which party has the duty to pay the taxes. Even if an inferior lender has no duty to pay taxes, it would seem reasonable that an entity appointed by a court at the request of the inferior secured creditor has an obligation to act as a fiduciary to preserve the property, including payment of taxes. If a lender pays taxes, a lender can be subrogated to the rights as against the owner.³³ If a fiduciary fails to pay taxes, it would seem reasonable that the fiduciary should be liable to all who suffer damages.

It is respectfully suggested that this is an area worthy of further jurisprudence and development.

II. LOUISIANA DEFICIENCY JUDGMENT ACT AND 1995 LEGISLATION

Act 1023 of 1995 alters the rules on deficiency judgments. It does not amend the Deficiency Judgment Act (La. R.S. 13:4106 *et seq.*), but rather amends Code of Civil Procedure article 2336. Prior to this change, the Deficiency Judgment Act allowed a creditor a significant windfall if the creditor proceeded to the second sale.

Under the Deficiency Judgment Act, a creditor who invokes judicial sale without appraisal is prohibited from obtaining a deficiency judgment.³⁴ The Deficiency Judgment Act is expressly stated as a "public policy" provision.³⁵ Thus, a creditor wishing to obtain a deficiency judgment by means of a judicial foreclosure must proceed with appraisal. Yet, the Code of Civil Procedure, until its amendment in 1995, allowed a creditor to invoke a second sale in the event a bid was not received at the first sale in excess of two-thirds of the appraised price or superior liens and encumbrances.³⁶ As a practical matter, there often is no adverse bidding at sheriffs' sales; it is not unusual that the only bidder is the secured creditor. Therefore, if there are no superior liens or encumbrances, and if the foreclosing creditor itself does not bid two-thirds of appraised value at the first sale, the creditor effectively can force a second sale. At the second sale, prior to the 1995 amendment, the minimum bid was the greater of superior liens and encumbrances, or, if none existed, costs.³⁷

The 1995 legislation prevents creditors from obtaining a windfall at the second sale by requiring that the creditor reduce the balance owed after the sale, regardless of whether there was adverse bidding and regardless of the amount for which the property was sold. The act provides:

33. See La. Civ. Code arts. 1825-1830.

34. La. R.S. 13:4106 (1991). The only exception to this rule involves post-default agreements under the provisions of La. R.S. 13:4108.1 (1991); and La. R.S. 4108.2 (1991).

35. La. R.S. 13:4107 (1991).

36. La. Code Civ. P. arts. 2335-2337.

37. La. Code Civ. P. arts. 2335-2336.

The debt owed to the seizing creditor shall not be reduced by the costs of the sale, but shall be reduced by the greater of either one-half of the appraised value, less superior security interests, mortgages, liens and privileges, or the amount by which the price bid exceeds superior security interests, mortgages, liens and privileges.

Note that this provision does not mandate any particular bid price. The creditor at the second sale can still bid costs, but nonetheless the creditor must reduce the debt by the amount called for in the statute. Some examples may explain the situation more clearly.

Example No. 1 Assume that Creditor A has a mortgage for \$120,000.00 on a tract of land in Louisiana. Creditor A is the only mortgagee or lienholder on the property. If the property appraises for \$120,000.00, the minimum bid at the first sale is \$80,000.00, two-thirds of the appraised value. Under this example, it makes no difference whether the proceeding is under the former version of Code of Civil Procedure art. 2336 or the 1995-amended version of 2236; in either case, if a minimum two-thirds is not bid, a second sale is required.

Example No. 2 Assume the same facts as in Example 1 and assume that this transaction takes place prior to the 1995 amendment to article 2336. At the second sale, the minimum bid for Creditor A is costs. If there is no other adverse bidding, Creditor A is able to purchase the entire property, apply no money to the debt, and still sue the Debtor for a deficiency of \$120,000.00. In other words, Creditor A has received a 100% windfall, having both the property worth \$120,000.00 and being able to sue the Debtor for a \$120,000.00 deficiency.³⁸

Example No. 3 Assume the same facts as in Example 2, except now the transaction occurs after the 1995 amendment to Code of Civil Procedure art. 2336. At the second sale the minimum bid that Creditor A must give the sheriff is still costs; yet, although Creditor A has bid only costs, Creditor A must reduce the amount of the deficiency by "one-half of the appraised value."³⁹ Thus, in this Example, although Creditor A bid only costs, Creditor A could collect from the debtor only a \$60,000.00 deficiency (one-half of the appraised value).

Example No. 4 Assume the same facts as in Example 3, except that there exists a superior lienholder who has a \$10,000.00 mortgage that

38. For a discussion of the "windfall" problem, see Michael H. Rubin, *Recent Developments in the Law, 1987-88: Security Devices*, 49 La. L. Rev. 495, 501-03 (1988); Michael H. Rubin & R. Marshall Grodner, *Recent Developments: 1991-1992, Security Devices*, 53 La. L. Rev. 969 (1993).

39. La. Code Civ. P. art. 2336 (as amended by 1995 La. Acts No. 1023, § 1).

primes Creditor A's mortgage. Now, the minimum bid at the second sale is \$10,000.00, the amount of the superior lienholder's claim.⁴⁰ If Creditor A purchases the property for the \$10,000.00 bid price, Creditor A must reduce the debt by \$50,000.00 (i.e. "one-half of the appraised value," or \$60,000.00, "less superior security interests," \$10,000.00).⁴¹

Example No. 5 Assume the same facts as in Example 3, except now there is a superior lienholder who has a \$200,000.00 first mortgage. At the second sale the minimum bid is \$200,000.00, for "if the price offered by the highest bidder at the first or subsequent offering is not sufficient to discharge the costs of the sale and security interests, mortgages, liens and privileges superior to those of the seizing creditor, the property shall not be sold."⁴² Leaving aside logic for a minute (e.g. why would Creditor A bid \$200,000.00 to buy a \$120,000.00 tract of land encumbered by a \$200,000.00 first mortgage?), if Creditor A does bid \$200,000.00, then Creditor A will have the property. Creditor A also can collect a \$120,000.00 deficiency from the Debtor. The reason is that although the bid price exceeds the appraised value of the property, it does not exceed "superior security interests, mortgages, liens and privileges."⁴³

Example No. 6 Under this example, Creditor A is a second ranking creditor with a \$120,000.00 mortgage. Creditor 1 is a superior ranking creditor whose mortgage is for \$900,000.00. The property in this example appraises for \$1,200,000.00.

Now, the minimum bid at the first sale is the greater of two-thirds of the appraised value (\$800,000.00) or superior liens and encumbrances (\$900,000.00); therefore, the minimum bid at the first sale is \$900,000.00. At the second sale, the minimum bid is still \$900,000.00, because that is the amount of the superior lien.⁴⁴ If Creditor 2 bids \$1,000,000.00 for the property, then the amount of the deficiency that Creditor A can collect is only \$20,000.00. The reason for this is that the successful bid price (\$1,000,000.00) exceeds superior liens by \$100,000.00. The debt of \$120,000.00 owed by the Debtor to Creditor A must be reduced by "the amount by which the price exceeds superior security interests, mortgages, liens and privileges." Because the bid price exceeds by \$100,000.00 the \$900,000.00 first mortgage, Creditor A's debt of \$120,000.00 must be reduced by the \$100,000.00 amount

40. La. Code Civ. P. art. 2337.

41. La. Code Civ. P. art. 2336 (as amended by 1995 La. Acts No. 1023, § 1).

42. La. Code Civ. P. art. 2337.

43. La. Code Civ. P. art. 2336 (as amended by 1995 La. Acts No. 1023, § 1).

44. La. Code Civ. P. art. 2337.

bid in excess of the \$900,000.00 first mortgage. Therefore, \$120,000.00 minus \$100,000.00 equals \$20,000.00.

Act 1023 of 1995 was a recommendation of the Louisiana Law Institute. The amendment protects debtors from creditors who, in the past, have routinely gone to second sales in order to obtain a windfall and maintain a huge deficiency judgment.

III. FEDERAL LAW PREEMPTION AND IMPLICATIONS FOR THE DEFICIENCY JUDGMENT ACT

A development involving the Deficiency Judgment Act is the evolving federal jurisprudence by which federal law may preempt all state requirements concerning deficiency judgments.

*Farm Credit Bank of Texas v. Farish*⁴⁵ dealt with federal preemption of the Louisiana Deficiency Judgment Act under the Farm Credit Act. The case held that the Louisiana Deficiency Judgment Act does not apply to a loan under the Farm Credit Act and that the Farm Credit Act provisions preempt the Louisiana Deficiency Judgment Act.

The facts are worthy of discussion to understand the importance of the holding. Farish had borrowed \$355,000.00 from the Federal Land Bank of New Orleans and secured the loan by a mortgage; the loan was pursuant to the Farm Credit Act of 1971.⁴⁶ As part of the loan process and the Farm Credit Act, Farish was required to purchase shares of Federal Land Bank stock and use this to secure the loan as well. In 1986 Farish stopped making payments on his loan and the Federal Land Bank declared the loan to be in default and accelerated the note. A workout plan fell through, although Farish agreed that his FLB stock could be cancelled.

In 1989, further workout arrangements failed and the Federal Land Bank sued Farish in state court to foreclose on the mortgage and recover the balance; the state court temporarily enjoined the FLB from foreclosing "because the FLB had not given [Farish] adequate time under the Farm Credit Act to request review. The [state] court's ruling meant that the FLB was enjoined from foreclosing until it complied with the Farm Credit Act's procedures. The state court *did not* say that the FLB could never collect."⁴⁷

Later, the loan was assigned to the Federal Credit Bank of Texas which brought suit in federal court seeking the outstanding balance of the loan; Farish defended against liability under the Deficiency Judgment Act,⁴⁸ because the stock had not been sold at a judicial sale. The lower court held that the Farm

45. 32 F.3d 184 (5th Cir. 1994).

46. 12 U.S.C. §§ 2001-2279(b)(6) (1994).

47. 32 F.3d at 186 (emphasis added).

48. La. R.S. 13:4106 (1991).

Credit Act preempted state law and the Fifth Circuit affirmed, reasoning that "[t]he Farm Credit Act does not require any appraisal of the stock purchased . . . [i]n fact an appraisal would be superfluous" because the stock had an agreed upon price and the value "was fixed by the Act despite any perceived change in 'market' value."⁴⁹ "Moreover even if the [Louisiana Deficiency Judgment Act] were applicable, it would be preempted by the Federal Credit Act."⁵⁰

The result in *Farish* is not unexpected for two reasons. First, even prior to the 1986 enactment of Louisiana Revised Statutes 13:4108,⁵¹ jurisprudential exceptions had been made to the Deficiency Judgment Act's prohibitions when federal bankruptcy procedures were involved.⁵² Second, Louisiana Revised Statutes 13:4108 created a number of exceptions involving stock that was publicly traded⁵³ on the theory that an appraisal is unnecessary if there is a sale in the nationally-regulated stock markets, for there is no better arbiter of price than what can be obtained at any point in time by a sale in those highly competitive and fluid markets. Since the stock in *Farish* could only be sold back to the federally-regulated Land Bank and had no other real market, the result is in line with Louisiana jurisprudence.

United States v. Succession of Siddon,⁵⁴ while not dealing directly with the Deficiency Judgment Act, gives a possible indication of the expansion of federal preemption of state mortgage and foreclosure law. In *Siddon*, a mortgage was allowed to be foreclosed upon even though the note had prescribed. The facts are worthy of note.

In April, 1991, Mr. and Mrs. Siddon delivered to the Farmers Home Administration (FmHA) two promissory notes with balloon payments due in 2001. A mortgage was given as a security for both notes. The Siddons never made payments on the notes and the FmHA, after Mrs. Siddon died, accelerated the notes. Mr. Siddon then died. The acceleration letters were sent in March, 1987 and foreclosure began more than five years later, in 1992. The estates of the decedents objected to the foreclosure claiming that, when the notes had prescribed, the mortgages had ceased to be enforceable as accessory obligations.

The district court rejected the argument of the borrowers. Without any detailed mention of state law, which clearly would not allow a creditor to foreclose on a mortgage when the principal obligation has ceased to exist,⁵⁵ the

49. 32 F.3d at 187-88.

50. 32 F.3d at 188.

51. 1986 La. Acts No. 489, § 2.

52. *Exchange National Bank v. Spalitta*, 321 So. 2d 338 (La. 1975).

53. La. R.S. 13:4108(1) (1991).

54. 812 F. Supp. 674 (E.D. La. 1993).

55. A mortgage is an accessory obligation; it is a "non-possessory right created over property to secure the performance of an obligation." La. Civ. Code art. 3278. A mortgage is "accessory to the obligation that it secures." La. Civ. Code art. 3282. Louisiana Civil Code article 3282 states expressly that "except as provided by law, the mortgagee may enforce the mortgage only to the extent that he may enforce any obligation it secures." The phrase "except as provided by law" was added by the Law Institute as part of the 1991 revisions to Louisiana Civil Code article 3282 to make

court found no problem in allowing the foreclosure to proceed. The court held that 28 U.S.C. § 2415(a) barred any claim of the administrator of the estates to halt foreclosure on a prescribed note. This provision is a six year statute of limitations for claims against the United States on "every action for money damages." The court's discussion dealt with the fact that this federal statute "does not apply to foreclosure actions."⁵⁶ The court pointed out that the same statute, 28 U.S.C. § 2415(c), states nothing "shall be construed to limit the United States' time for bringing an action to establish title to or right to possess real or personal property,"⁵⁷ and read this to mean that if the six year statute of limitations had not elapsed, the United States could foreclose with impunity.

The court did not discuss at all the fact that Civil Code article 3319(3) states that a mortgage is extinguished "by a prescription of all the obligations that the mortgage secures." It is not clear from reading the court's reasoning whether the foreclosure here was purely under federal law, and the court did not discuss whether *Erie Railroad Co. v. Tompkins*⁵⁸ requires that state law be applied to determine the enforceability of the obligation. If foreclosure can occur despite the fact that the note had prescribed, essentially a creditor may be able to use federal law to obtain something that would never be permitted under state law. The court in essence transformed an unenforceable obligation under state law into an *in rem* obligation whose sole prescriptive period was controlled by federal law. Under state law, the creditor could not have foreclosed on the property and could not have obtained money from the debtor, either by suing on the note or on the property. It appears that the mere fact that the creditor was a federal entity gave it rights far superior to that of any other similarly-situated Louisiana creditor holding a mortgage on exactly the same tract of land in Louisiana.

It may be that *Succession of Siddon* is merely in line with other federal jurisprudence that expands, through preemption, federal claims over state foreclosure and mortgage procedures.⁵⁹ On the other hand, such a trend appears

it clear that a mortgage may be given to enforce an *in rem* (i.e. non-recourse) obligation. 1991 La. Acts No. 652, § 1. See La. Civ. Code art. 3282 comments; see also La. Civ. Code art. 3297 (which expressly provides for non-recourse mortgages). Under Louisiana Civil Code article 3319, a mortgage is extinguished as between the parties when there is "prescription of all obligations that the mortgage secures."

56. 812 F. Supp. at 676.

57. *Id.* at 676.

58. 391 U.S. 64, 58 S. Ct. 817 (1938).

59. See *HUD v. Jones—Williams*, 870 F. Supp. 90 (M.D. Pa. 1994) (holding that the National Housing Act (12 U.S.C. § 1701-1750) and its implementing regulations (24 C.F.R. § 203.640) preempt state law that may require actions inconsistent with HUD foreclosures in federal court). In this case the defendant claimed that the HUD foreclosure was improper because the notice prior to the foreclosure did not comply with Pennsylvania law; the Court rejected the argument and aligned itself with other federal courts. See, e.g., *United States v. Spears*, 859 F.2d 284 (3d Cir. 1988) (a Farmer's Home Administration (FmHA) foreclosure). Cf. *United States v. Stohr*, No. Civ.A. 92-2981, 1993 WL 44238 (E.D. Pa. Feb. 22, 1993).

disturbing, for it creates a separate body of law that affects immovable property in the state of Louisiana, a body of law that is at odds with Louisiana's Civil Code and civilian methodology.

IV. SURETYSHIP AND PAROL EVIDENCE

The Civil Code is explicit: parol evidence is not admissible to prove either that one is a surety or what the surety's "promise" concerned. Louisiana Civil Code article 1847 states: "Parol evidence is inadmissible to establish either (a) a promise to pay the debt of a third person or a promise to pay a debt extinguished by prescription." Louisiana Civil Code article 3038 provides that "Suretyship must be express and in writing."

Despite the fact that parol evidence is inadmissible to prove a contract of suretyship, nonetheless some courts have seemed to allow parol evidence to "explain away" what otherwise appears on its face to be a binding obligation. This appears to occur primarily when the debtor is a thinly-capitalized corporation with only a few shareholders and those shareholders either sign documents in an ambiguous capacity or orally agree to pay debts. It would appear that these cases may not be indicative of the way the Louisiana Supreme Court might rule.

It is submitted that the leading case in the area whose reasoning should be followed is *Seashell, Inc. v. Simon*.⁶⁰ *Seashell* held that parol evidence cannot be used in any form to prove that someone agreed to be a surety. If the allegation is that a person agreed to pay if the corporation did not, then one has alleged the essentials of a suretyship and parol evidence, therefore, should be inadmissible. On the other hand, parol evidence is permitted to show that one undertook a separate, new, independent, and principal (as opposed to accessory) obligation.⁶¹

Though *Seashell* seems to set forth the correct rule under the clear language of the Civil Code provisions, some Louisiana appellate courts have stated, cryptically and without any citation of authority, that a person who admits to being a surety nonetheless might be able to use parol evidence to "explain away" portions of the suretyship agreement or to limit the agreement more narrowly than the language of the contract indicates. The primary case taking this view is *First Acadiana Bank v. Bollich*,⁶² in which parol evidence apparently was not objected to at the trial level, or, if it was, the overruling of the objection was not appealed. Reliance upon this case by debtors, therefore, seems questionable.

Thus, a discrepancy seems to be developing in the jurisprudence. On the one hand, the *Seashell* case holds that a creditor who alleges a secondary

60. 398 So. 2d 99 (La. App. 3d Cir. 1981).

61. See, e.g., *Klein v. Collins*, 159 La. 704, 106 So. 120 (1925). See also Rubin, *supra* note 38, at 505-08.

62. 532 So. 2d 248 (La. App. 3d Cir. 1988).

obligation must treat the debtor as a surety, despite any ostensible language of solidarity or primary obligation.⁶³ On the other hand, under the *Bollich* case, debtors may be able to somehow "explain away" their liability, although, as noted, *Bollich* may be limited to its facts under the procedural posture in which it was presented.

With this in mind, it is interesting to look at a case decided by the Fourth Circuit which found that the principal shareholder of a company had taken on primary responsibility for company debts, notwithstanding the testimony of the creditor that the liability was secondary. In *Nesser, King & LeBlanc v. Laredo Marine Services, Inc.*,⁶⁴ a law firm filed a suit over its fees. Over "four or five years" the law firm represented the principal shareholder's related companies "in six or seven fairly significant disputes."⁶⁵ One of the client companies incurred significant legal fees to the firm and then later went bankrupt. The law firm claimed it received an "oral promise" from the principal shareholder to "personally pay all future fees and costs incurred in connection with [the firm's] representation" in one of the suits, although there was nothing in writing to confirm the promise.⁶⁶ The court found the law firm could collect the fees from the principal shareholder, reasoning:

If a promisor unconditionally obligates himself to pay the debt of another, he becomes primarily responsible for the debt. This promise does not create a suretyship and can be proved with parole (sic) evidence.⁶⁷

While it is clear that one who is a surety may later become a principal obligor by undertaking a new, oral principal obligation,⁶⁸ in this case the testimony discussed by the appellate court appears to be at odds with the court's rationale. The appellate court itself quoted testimony by one of the attorneys in the law firm that the principal shareholder made the statement that if the company "can't pay, he will pay."⁶⁹ This appears to be an admission of a suretyship claim.⁷⁰

Suretyship is an accessory obligation "by which a person binds himself to a creditor to fulfill the obligation of another upon the failure of the latter to do so."⁷¹ Civil Code article 1847 prohibits parole evidence to prove a promise "to pay the debt of a third person." As *Seashell v. Simon* noted, an allegation that one enters into an agreement to pay on behalf of somebody else or to pay if they do not is the essence

63. See La. Civ. Code art. 3037.

64. 630 So. 2d 327 (La. App. 4th Cir.), writ denied, 637 So. 2d 462 (1994).

65. *Id.*

66. 630 So. 2d at 328.

67. 630 So. 2d at 329.

68. *Klein v. Collins*, 159 La. 704, 106 So. 120 (1925).

69. 630 So. 2d at 328.

70. See, e.g., *Amory v. Boyd*, 5 Mart. (o.s.) 414 (La. 1818); *Hickey v. Dudley*, 9 Rob. 502 (La. 1845); *Menard & Vignaud v. Scudder & Stewart*, 7 La. Ann. 385 (1852).

71. La. Civ. Code art. 3035.

of suretyship, and "any parol evidence which might be offered" on this point should be "inadmissible."⁷²

V. PRIVILEGES V. U.C.C. ARTICLE 9

Louisiana's version of U.C.C. 9⁷³ is now beginning to have case law reported under it. As part of the work the Louisiana Law Institute did in correlating U.C.C. provisions with Louisiana privilege provisions, the portions of Louisiana's version of Article 9-102 controlling ranking of security interest is non-uniform and provides generally that a "UCC" security interest outranks all statutory liens except possessory liens. In addition, Louisiana enacted Louisiana Revised Statutes 9:4770, which has been amended several times since 1990; the essence of this provision (and others in the Civil Code ancillaries) is that a Louisiana Commercial Law security interest outranks a post-1990 privilege. Louisiana also has enacted Louisiana Revised Statutes 9:4521, which provides that certain privileges outrank a Chapter 9 and U.C.C. Article 9 perfected security interest "as a specific exception to R.S. 9:4770 and R.S. 10:9-201."⁷⁴

The Louisiana Supreme Court had an opportunity to review these statutes in a federal case involving a Louisiana shipbuilder's privilege and a Louisiana Commercial Laws Article 9 security interest.⁷⁵

In *Beckwith Machinery*, the court promulgated an important rule of interpretation of Louisiana Law. The court began by noting that Louisiana's rules of ranking of security interests, contained Chapter 9-201, are not the same as Article 9-201 of the Uniform Commercial Code and mandate a result that differs from the general rules set forth in U.C.C. Article 9.⁷⁶ The Court found that the Louisiana non-uniform statute provides a clear rule in ranking Chapter 9 security interests against privileges, whether the privileges are possessory or non-possessory. All Louisiana privileges, regardless of their origin or type, are inferior Chapter 9 security interests "unless these privileges fall into one of the limited exceptions giving them priority."⁷⁷ Examining these exceptions, the court set forth a two-step test

72. 398 So. 2d 99, 102 (La. App. 3d Cir. 1981).

73. Louisiana Commercial Laws (R.S. 10:9-101 et seq.) effective January 1, 1995.

74. La. R.S. 9:4521 (Supp. 1996).

75. *First National Bank v. Beckwith Machinery Co.*, 26 F.3d 580 (5th Cir. 1994); *see also* 650 So. 2d 1148 (La. 1995).

76. "Louisiana is the *only state* which includes in its version of Article 9-201 language explicitly making the security interest effective against creditors holding *liens* on the same property. Louisiana is also the *only state* which specifically makes liens subject to the provisions of §10:9-201 in addition to §10:9-310." 650 So. 2d at 1152.

Also note that Louisiana has not adopted the Official Comments to the Uniform Commercial Code; therefore, they are not even persuasive authority, although Law Institute Comments would be persuasive authority. *Montelepre v. Edwards*, 359 So. 2d 1311 (La. App. 4th Cir. 1978); *American Deposit Ins. Co. v. Walker*, 450 So. 2d 33 (La. App. 3d Cir. 1984); *Sizeler Property Investors, Inc. v. Gordon Jewelry Corp.*, 550 So. 2d 237 (La. App. 4th Cir. 1989), *writ denied*, 551 So. 2d 1327.

77. *Beckwith*, 650 So. 2d at 1152. The reference to the limited exceptions are those contained

determining whether a Louisiana privilege primes a perfected Chapter 9 security interest. It should be noted, in reviewing this area, that even if the privilege arises first in time, the later-arising Chapter 9 security interest will nonetheless outrank the privilege *unless* the specific statutory exception is met. The Supreme Court set forth the test succinctly:

A lien is subordinate to a perfected Chapter 9 security interest unless: (1) the statute creating the lien expressly provides to the contrary, *and* (2) the lien depends on the possession of the lien holder.⁷⁸

There are certain Louisiana statutes that contain privileges falling within the scope of the exception. For example, a repairman's privilege on automobiles under Louisiana Revised Statutes 9:4501⁷⁹ provides that a prior-perfected Chapter 9 security interest outranks the repairman's privilege; on the other hand, a later-perfected security interest under Chapter 9 will not outrank the repairman's privilege once the privilege has arisen as long as the repairman maintains possession of the car.⁸⁰ This statutory rule complies with *Beckwith Machinery*, for possession is the key to outranking the *later-perfected* security interest.⁸¹

Beckwith Machinery contains an important lesson for all Louisiana creditors who previously have relied upon privileges on movables to protect their interests. Under the *Beckwith Machinery* reading of Louisiana's version of U.C.C. 9, unless there is an express statute to the contrary, almost all privileges on movables will be outranked by a later-perfected Chapter 9 security interest. Thus, creditors holding a privilege who wish to protect themselves (such as creditors holding a lessor's privilege or a vendor's privilege on movables)⁸² would be well-advised to take a

in La. R.S. 10:9-201 (1993); and La. R.S. 10:9-310 (1993).

78. 650 So. 2d at 1153.

79. La. R.S. 9:4501 (1991) (as amended by 1989 La. Acts No. 137, § 4).

80. Under La. R.S. 9:4501(A) (1991), the privilege is effective

for a period of 120 days from the last day on which materials were furnished or labor was performed if the thing affected by such privilege is removed from the place of business where such labor was performed or materials were furnished; provided that if the thing affected by such privilege remains in the place of business of the person who furnished such materials or performed such labor, such privilege continues as long as such thing remains in such place of business.

81. Under La. R.S. 9:4501(B) (1991) the repairman's privilege is superior to "a *previously* perfected security interest under Chapter 9 of Louisiana Commercial Laws." (emphasis added).

82. Chapter 9 of Louisiana's Commercial Laws does not provide a mechanism for getting a security interest in leases. La. R.S. 10:9-101 to -605 (1993 & Supp. 1996). The only mechanism to get a security interest in a lease income stream is under R.S. 9:4401 (Supp. 1996). On the other hand, a Chapter 9 security interest can affect movables on a leased premises, movables which are subject to a lessor's privilege. La. Civ. Code art. 2705.

Chapter 9 also does not apply to immovable property. Chapter 9 does contain a mechanism for granting a security interest in fixtures. La. R.S. 10:9-313 (1993). Fixtures are essentially those items that become component parts of a movable. Cf. La. Civ. Code art. 466-469. Therefore, a Chapter 9 security interest would never affect all of the immovable, but only the fixture, and only if the security interest is properly perfected. It is beyond the scope of this article to comment on Chapter

Chapter 9 security interest as a matter of course. The failure of a Louisiana privilege holder to take a Chapter 9 security interest creates the risk that, at some point in the future, a Chapter 9 security interest will be perfected that will outrank the privilege.

VI. UPDATE ON DUE PROCESS

Procedural due process issues continue to have an impact on Louisiana foreclosures.⁸³ The rule, generally speaking, is that due process requires owners, mortgage holders and other possessors of "real rights" to be given constitutionally-required notices prior to being deprived of property rights.⁸⁴ Questions, however, do arise as to which parties have "property rights;" if there is no "property right," then there is no due process impingement under the United States Constitution. Whether there is a due process claim under the State Constitution is a different issue (and beyond the scope of this article).

A. "Due Process" Notice to Guarantors and Sureties

It is clear that because guarantors do not have any "real rights in property" they are not entitled to any *Mennonite* notices.⁸⁵ The notice issue under the *Mennonite*

9 fixture filings, but it should be noted that they only apply to commercial (as opposed to residential) establishments, and such filings must be made prior to attachment of the item that becomes a fixture. *Id.*

83. The key procedural due process cases (in chronological order) are: *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 70 S. Ct. 652 (1950); *Sniadach v. Family Fin. Corp.*, 395 U.S. 337, 89 S. Ct. 1820 (1969); *Fuentes v. Shevin*, 407 U.S. 67, 92 S. Ct. 1983, *reh'g denied*, 409 U.S. 902, 93 S. Ct. 177, 180 (1972); *Buckner v. Carmack*, 263 La. 627, 272 So. 2d 326 (1973), *writ refused*, 417 U.S. 901, 94 S. Ct. 2594 (1974); *Mitchell v. W.T. Grant Co.*, 416 U.S. 600, 94 S. Ct. 1895 (1974); *Bonner v. B-W Utilities*, 452 F. Supp. 1295 (W.D. La. 1978); *Flagg Bros. v. Brooks*, 436 U.S. 149, 98 S. Ct. 1729 (1978); *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 102 S. Ct. 2744 (1982); *Mennonite Board of Missions v. Adams*, 462 U.S. 791, 103 S. Ct. 2706 (1983); *Magee v. Amiss*, 502 So. 2d 568 (La. 1987); *Tulsa Professional Collection Servs., Inc. v. Pope*, 485 U.S. 478, 108 S. Ct. 1340 (1988); *Davis Oil Co. v. Mills*, 873 F.2d 774 (5th Cir.), *reh'g denied*, 877 F.2d 972 (5th Cir.), *cert. denied*, 493 U.S. 937, 110 S. Ct. 331 (1989); *Small Engine Shop v. Cascio*, 878 F.2d 883 (5th Cir. 1989); *Sterling v. Block*, 953 F.2d 198 (5th Cir. 1992); *Connecticut v. Doeher*, 501 U.S. 1, 111 S. Ct. 2105 (1991); *Wyatt v. Cole*, 504 U.S. 158, 112 S. Ct. 1827 (1992).

84. See, e.g., *Magee*, 502 So. 2d at 568. See also Rubin, *supra* note 38, at 495; Michael H. Rubin & E. Keith Carter, *Notice of Seizure in Mortgage Foreclosures and Tax Sale Proceedings: The Ramifications of Mennonite*, 48 La. L. Rev. 535 (1988); Rubin & Grodner, *supra* note 38, at 969.

85. See *FDIC v. Rouse*, 859 F. Supp. 234 (E.D. La. 1994). One might argue that guarantors are being deprived of their rights of subrogation or that there is an impairment of their right of subrogation if the property is sold without notice to them. Guarantors might claim that if they had notice of the foreclosure action, they could either have come in and "bid up" the property or made sure that it went for a more "reasonable" price. Such a claim, however, seems to find no support in statutes or jurisprudence, and it seems that if guarantors used this theory, they are relying upon a tenuous thread. A finding that guarantors are not entitled to notice is in accord with the operative portions of the Deficiency Judgment Act (La. R.S. 13:4106-4107) which refer only to "debtors"; there is no reference

rationale, however, is related to notice under the Deficiency Judgment Act. It might be argued by some that one would not be entitled to *Mennonite* notice (because a surety or guarantor does not have any "property rights" to property) and yet be entitled to notice under the Deficiency Judgment Act. This argument has been raised several times, and Louisiana courts uniformly have rejected the theory that sureties are entitled to notice of foreclosure under the Deficiency Judgment Act.⁸⁶

B. Notice and Property Rights

While notice to guarantors is not required of foreclosure sales under either *Mennonite* or the Deficiency Judgment Act, notice to those who have a property interest is crucial. As the Fifth Circuit noted in *Greater Slidell Auto Auction, Inc. v. American Bank & Trust Company*:⁸⁷

We are also persuaded by Plaintiffs' argument that failure to provide them notice by mail violates their right to due process. Mailing of notice to claimants known to the receiver is constitutionally required; for such claimants, publication of notice (which is sufficient for unknown claimants) is constitutionally infirm. See *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 317-20, 70 S.Ct. 652, 658-60, 94 L.Ed. 865 (1950); *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 798-800, 103 S.Ct. 2706, 2711-12, 77 L.Ed.2d 180 (1983); see also *Whatley*, at 911 (Duhé, J., concurring). The statutory requirement of mailed notice to claimants who become known applies as a constitutional minimum to a claimant known by reason of a law suit pending when the receiver is appointed.

C. Due Process and Attachment

Because any prejudgment attachment of property can deprive persons of their due process rights, prejudgment attachments are subject to strict scrutiny.

to guarantors. While there is a split of authority about whether sureties can utilize the Deficiency Judgment Act to get a release if the debtor did not get notice, see Rubin & Grodner, *supra* note 38, Louisiana case law appears well settled that sureties are not entitled either to notice of the foreclosure sale or the right to appoint an appraiser. See *Cameron Brown South, Inc. v. East Glen Oaks, Inc.*, 341 So. 2d 450 (La. App. 1st Cir. 1976); *Gumina v. Dupas*, 178 So. 2d 291 (La. App. 4th Cir. 1965).

86. See *Security Nat'l Trust v. Moore*, 630 So. 2d 373 (La. App. 2d Cir. 1994). There, the court distinguished *Citizen's Savings & Loan Ass'n v. Kinchen*, 622 So. 2d 662 (La. 1993); and *Security Homestead Ass'n v. Fuselier*, 591 So. 2d 335 (La. 1991) ("in each [of these cases] the original debtor-mortgagor did not receive appropriate notice during the previous foreclosure . . . however, the protection afforded the mortgage debtor by the deficiency judgment act and previously discussed cases have not been extended to endorers"). For a more extensive discussion of the notice issue see Rubin & Carter, *supra* 84, at 564-68.

87. 32 F.3d 939, 942 (5th Cir. 1994).

Louisiana's sequestration statutes previously have been held valid by the United States Supreme Court in *Mitchell v. W.T. Grant & Co.*⁸⁸ In a recent case that relied on *W.T. Grant*, an appellate court has held that Louisiana's attachment provisions (quasi in rem jurisdiction over non-residents) do not violate the federal constitution.⁸⁹

D. Due Process Property Rights, and First Rights of Refusal

The importance of defining who has and what is a "property right" was raised by *Resolution Trust Corporation v. Charles House Condominium Association, Inc.*⁹⁰ The RTC, as successor in interest to a savings and loan, was the holder of three promissory notes secured by mortgages on condominium units. In June, 1989, the owner transferred title to all three condominium units under a *dation en paiement* to the savings and loan. When RTC tried to market the property, the title company claimed that the condominium declaration was a title impediment because a condominium association had the first right of refusal to purchase the unit "upon terms described in the notice of the proposed transfer."

The condominium association attempted to exercise its first right of refusal against the RTC and when a dispute developed, the RTC filed this suit for declaratory judgment that the first right of refusal "constitutes a cloud on the Receiver's title to property" and was unenforceable.⁹¹

The condominium association lost the case because the court found that a contractual first right of refusal does not create a constitutionally protected interest in property. As noted earlier in this article, federal preemption is playing an even-larger role in state property and security issues, and this case illustrates how invasive preemption can be. Citing 12 U.S.C. § 1821(d)(2)(G)(i)(II) and federal case law,⁹² the court found that a federal right of first refusal is not a constitutional property interest. The court attempted to distinguish *Travis v. Heirs of Felker*,⁹³ finding that a Louisiana first right of refusal only gives the party a "preferred right to buy property if the seller decides to sell."

Determining what Louisiana real estate law is by distinguishing a Louisiana case and relying on common law authorities seems particularly inappropriate given Louisiana's Civil Code and civilian methodology, the fact that Louisiana is a "title" and not a "deed of trust" state, and most importantly, because of Louisiana's Public Records Doctrine.⁹⁴ It is submitted that *Travis v. Felker*

88. 416 U.S. 600, 94 S. Ct. 1895 (1974).

89. *Alessi v. Belanger*, 644 So. 2d 778 (La. App. 1st Cir. 1994).

90. 853 F. Supp. 226 (E.D. La. 1994).

91. 853 F. Supp. at 228.

92. 853 F. Supp. at 230. *See Kaiser Dev. Co. v. City & County of Honolulu*, 649 F. Supp. 926 (D. Hawaii 1986), *aff'd*, 898 F.2d 112 (9th Cir. 1990), *amended and superseded*, 913 F.2d 573 (9th Cir. 1990), *cert. denied*, 499 U.S. 947, 111 S. Ct. 1414 (1991).

93. 482 So. 2d 5 (La. App. 1st Cir. 1985).

94. La. R.S. 9:2721-2759 (1991 & Supp. 1996).

stands for something more than a mere personal right of action under a first right of refusal. The first right of refusal, as *Travis v. Felker* held, was totally imprescriptible—it never prescribed.⁹⁵ This rule was only changed on January 1, 1995 when the amendments to Civil Code art. 2628 took effect;⁹⁶ now, a first right of refusal on immovable property “may not be granted for a term longer than ten years.”

Travis v. Felker involved more than merely forcing a purchaser to recognize the first right of refusal; part of the property already had been sold. Part of the rationale of the case is that, because a right of first refusal is imprescriptible and on the public records, a third party who purchases property subject to it must recognize it.

Louisiana law always has recognized a first right of refusal as a contract that affects immovable property. Indeed, Civil Code article 2629 (amended by 1993 La. Acts No. 841, § 1, effective January 1, 1995), states that a first right of refusal involving property “is effective against third persons only from the time the instrument that contains it is filed for registry in the parish where the immovable is located.” This amended article does not change the law. In the words of the Louisiana Law Institute:

(a) It gives legislative formulation to a principle established by Louisiana jurisprudence. *Versai Management, Inc. v. Monticello Forest Products Corp.*, 479 So.2d 477 (La. App. 1st Cir. 1985).

(b) Louisiana courts have recognized the enforceability of a right of first refusal affecting immovable property contained in their recorded instrument. See *Crawford v. Deshotels et al.*, 359 So. 2d 118 (La. 1978).⁹⁷

A similar rule exists with rights of redemption; these are real rights and affect third parties. Under Louisiana law, a recorded right of redemption permits the original seller to redeem the property even from the hands of third parties.⁹⁸ As the Official Law Institute Comments to art. 2572 states, a sale with a right of redemption “clearly subjects the rights of third persons of the Public Records Doctrine when the thing is immovable.” Under the Civil Code, the right of redemption “is effective against third persons . . . from the time the instrument that contains it is filed for registry in the parish where the immovable is located.”⁹⁹

95. *Keene v. Williams*, 423 So. 2d 1065, 1069 (La. 1982); *Crawford v. Deshotels*, 359 So. 2d 118, 122 (La. 1978); *Price v. Town of Ruston*, 171 La. 985, 132 So. 653, 656 (1931).

96. 1993 La. Acts No. 841, § 1.

97. La. Civ. Code art. 2629 cmts. a & b.

98. See La. Civ. Code arts. 2572 & 2574, amended by 1993 La. Acts No. 841, § 1 (effective January 1, 1995).

99. La. Civ. Code art. 2572.

The holding in *Charles House Condominium*, that the first right of refusal does not create a property right for notice purposes, seems insupportable as a matter of Louisiana law. Given the fact that the case appears to misinterpret Louisiana law, reliance upon it even as a matter of federal preemption may be tenuous, for it is questionable whether the nature of a secured creditor as a federal lender should alter the rights of those not a party to the federal lending document.

